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## NOTES

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### WASHINGTON NOTES

#### COMPLETION OF THE NEW LOAN

Completion of the new loan offered at two thousand million dollars by a subscription estimated to aggregate three billion dollars, the number of subscribers being in the neighborhood of four millions, has been the outstanding feature of public finance during the month of June. As is well understood, the proceeds of the loan have been in part anticipated through the placing of about one thousand million dollars of short-term certificates of indebtedness with banks, such certificates to be converted, if their holders desire, into the long-term bonds or, at the request of the holders, paid off out of the proceeds of the bond sale. Not the least significant aspect of the situation has been the fact that some 99 per cent of all of the subscriptions were in relatively small amounts—less than ten thousand dollars, and that, in the allotting of the new bonds to subscribers, the smaller applicants have been preferred, thereby placing these bonds presumably in the hands of the permanent individual investors.

Exactly how far these subscriptions have been effected on the basis of banking credit cannot be positively stated, but to some extent, at least, this has been the case. Prior to the completion of the subscriptions the federal reserve system, in the effort to render the banking resources of the country readily available, had taken a number of steps intended to facilitate rediscount of paper based on bonds, so that there need be no doubt that would-be subscribers could obtain such aid as they might stand in need of. The steps in the development of the Board's policy may be reviewed as follows:

1. Establishment of a rate of 3 per cent per annum for the discount at federal reserve banks of the direct obligations of member banks, secured by Treasury certificates of indebtedness. These certificates were issued at 3 and  $3\frac{1}{4}$  per cent per annum.

2. The establishment of a rate of discount at federal reserve banks of  $3\frac{1}{2}$  per cent per annum for customers' notes rediscounted with the indorsement of member banks when such notes had been originally given for the purpose of securing funds for the purchase of bonds.

3. The general grant of permission to member banks to act as agents of non-member banks in rediscounting the notes of the latter at federal reserve banks in order to obtain funds to facilitate the operations of such non-member banks in government bonds.

4. The establishment of a "one-day rate" of from 2 to 4 per cent for use in financial centers, chiefly in New York, for the purpose of restoring to the market funds temporarily withdrawn through government loan operations.

5. Provision that notes of non-member banks might be discounted at federal reserve banks with the indorsement of a member bank on the same basis as customers' notes (that is, running up to 90 days' maturity) on condition that such notes should be rediscounted only up to July 15, provided that such notes were accompanied by an affidavit that the proceeds thereof had been used for the purchase or carrying of bonds.

6. General assurance to savings banks and trust companies that the Board desired in every way to co-operate with them in avoiding shock or disturbance to existing conditions, and stood ready further to secure reasonable extension of accommodations at federal reserve banks for the purpose of protecting the interests of such savings banks and trust companies in the event of necessity resulting from the withdrawal of deposits in order to purchase or invest in government bonds.

#### AMENDMENTS TO FEDERAL RESERVE ACT

President Wilson, on June 21, affixed his signature to the bill amending the Federal Reserve act, which has been under consideration in both Houses at intervals practically ever since the beginning of the special session. The measure as now adopted makes essential changes in the Federal Reserve act—probably the two most important being those relating to the status of the federal reserve note and the composition of the reserves held by the federal reserve banks.

The federal reserve note, which is an obligation of the United States secured by an ample reserve of gold and commercial paper, has been accepted as willingly by the public as a national bank note or as any other form of currency, and the public does not discriminate between different forms of United States currency. Federal reserve note circulation has been substituted for gold certificates to the extent of about \$300,000,000.

Under the old law this gold was deposited with the federal reserve agents as special collateral or protection for the federal reserve notes issued upon receipt of it. The notes so provided for thereby, in effect, ceased to be obligations of the federal reserve bank by which they were

issued. Inasmuch, therefore, as the gold did not figure as an asset, the federal reserve banks were unable to show the greater cash reserve strength which might have been evidenced if the law had permitted, as provided in the amendments now adopted, the issuance of federal reserve notes, not only against commercial paper, but also against gold or against a combination of gold and paper at the pleasure of the bank. It is provided, now as always, that every federal reserve note must be covered by at least 100 per cent of commercial paper or gold, or both, and that gold must be held to an amount not less than 40 per cent of all outstanding federal reserve notes, although, under the amendments, this gold may be counted and reported as a part of the bank's note reserve, thus doing a double duty—as “collateral” and as reserve.

The control of gold by federal reserve banks in times of abundance such as at present, it is argued, will decrease the danger of inflation of domestic credits and at the same time will enable the country, when the tide turns, to part with large sums of gold with less inconvenience or shock, thus enabling us more safely and effectively to proceed with the development of our foreign trade and to give the necessary credit facilities for its extension. The United States should be in a position to face conditions which may call for an outflow of gold without any disturbances of our own or to the world's business, and without making necessary drastic changes in our interest or discount rates. The amendments enable the federal reserve banks to withdraw gold from actual circulation while enabling member banks at the same time to release gold which at present is tied up in their own vaults. The note amendments are based upon the theory that all of the individual banks should strengthen the gold holdings of the federal reserve banks. The country's holdings of gold are not used most effectively when they are in the vaults of a large number of banks scattered all over the country, but their greatest use would come from concentrating them to a greater degree in the vaults of the federal reserve banks, where the gold can be effectively protected when not required and effectively used when needed. The member bank does not require gold with which to supply the ordinary demands of its depositors so much as currency.

Probably the most striking feature of the amendments as adopted, however, is found in the fact that, while the percentages of reserves to be held with reserve banks under the new law are equal to the percentages required under the old law plus the amounts that might, at the option of the banks, have been deposited with them, it is now left to the determination of the local bank itself to fix the amount of currency and money

which it will carry in its own vaults. While of course this would permit a bank to reduce its vault cash to an unreasonably low level, the assumption is that it will not do so on account of the pressure of necessity from its customers. In some parts of the country experience has shown that even the old vault requirements were not sufficient, so that banks habitually kept much more than they were required by law to hold. In other parts of the country, where demand is very slack, it is probable that little cash need be carried by the banks in their vaults.

Among the other features contained in the new act that are of very considerable importance may be mentioned the following:

Amendments of Section 16 to permit non-member banks and trust companies, even though too small to be eligible for membership in the federal reserve banks, to avail themselves of the clearing and collection facilities of the federal reserve banks, provided that they cover at par checks on themselves sent for collection by the federal reserve bank, and provided, further, that they keep a compensating balance with the federal reserve bank in an amount to be determined under rules prescribed by the Federal Reserve Board. This is not intended to operate as an extension of any of the privileges of the federal reserve system to non-member banks at the expense of members, but, on the contrary, the amendment is proposed primarily for the convenience of the public, and incidentally for the benefit of the member banks. It is contemplated that the compensating balances which non-member banks participating in the clearing plan will be required to keep with the federal reserve banks will be sufficiently large to protect member banks and justify federal reserve banks in undertaking the service. Any clearing and collection plan to be effective must be so comprehensive as to include all checks. At present the par lists of the federal reserve banks include the names of banks, checks on which can be collected in any circumstances at a minimum of time and expense, but do not embrace a large number of towns in every state where there are no member banks; and in order to make collection on such points many banks are obliged to maintain accounts in addition to their reserve accounts with the federal reserve banks. A necessary factor in any successful clearing plan is the offset, whereby balances only require settlement instead of the total volume of transactions. As long as the clearing system does not embrace all of the banks, this offset is lost in a corresponding degree and the value of the system diminished in proportion.

Amendment of Section 22—the penal statute—so as to define more clearly the rights and limitations of directors in the matter of accepting

fees or compensation, other than the ordinary fees paid directors, for legitimate services rendered in the regular course of business, the performance of which service is not incumbent upon them in their capacity as directors.

Amendment of Section 13 to restore the provision which was by error stricken from the act in the amendments of September 7, 1916, thus restoring to national banks, with the approval of the Federal Reserve Board, the right to accept up to 100 per cent of their capital and surplus in transactions involving imports or exports.

Amendment of Section 17 to cancel the provision of the National Bank act which requires national banks to maintain a minimum deposit of government bonds with the Treasurer of the United States. National banks are no longer required to keep outstanding a minimum amount of circulating notes, and a newly organized bank is not obliged to purchase or carry any bonds of the United States; but there are a number of national banks organized before the passage of the Federal Reserve act which have retired their national bank circulation in full, yet they are, under a construction of the old law, required to keep on deposit with the Treasurer of the United States a certain minimum of United States bonds.

#### TRUST POWERS OF NATIONAL BANKS

On June 11 the federal Supreme Court handed down its decision in the case of *Bank v. Fellows*—a suit brought to determine the constitutionality of that provision of the Federal Reserve act which authorizes member banks to exercise the powers of executor, trustee, administrator, and other fiduciary functions. This suit had gone against the federal reserve system in the lower courts (in Michigan), it being there held that the provision of the Federal Reserve act under which these powers were granted was unconstitutional. This view the federal Supreme Court now declines to uphold, and in a positively expressed opinion takes the view that the section referred to is beyond doubt constitutional, and that the banks to which the Federal Reserve Board has granted the powers are therefore authorized to exercise them. The decision is of large banking importance because it indicates the intention of the judicial authorities to support legislation under which the national banks are allowed to occupy, in part, a region which has heretofore been reserved for the trust companies. In many states, as is well known, trust companies have already invaded the commercial banking field, and they will undoubtedly do so more and more as time goes on in other states. The way is thus paved toward a unification of function between the commercial banks and

trust companies which in time will tend toward a condition in which the different classes of institutions rest upon an identical footing. Entire identity will, of course, probably never be produced, but the decision now rendered will operate to eliminate the discrimination and unfairness that has grown out of the conditions existing in some states whereby trust companies could exercise commercial banking functions, while the commercial banks could not perform trust-company functions. The decision will also probably enable small banks to serve the needs of their various communities much better than at present, since there are many places of limited population or limited resources which cannot support more than one banking institution, and which consequently find themselves with a commercial bank of limited capitalization, but with no facilities for the performance of trust-company functions. From the legal standpoint the decision is interesting in that it shows the continued disposition of the Court to uphold Congress in vesting extensive power in Congress with regard to banking and monetary questions.